FOR ARGUMENT

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(76-1114, 76-1587)

IN THE

Supreme Court of the United States

OCTOBER TERM, 1977

EL PASO NATURAL GAS COMPANY, *Petitioner*
v.
SOUTHLAND ROYALTY COMPANY, *et al.*, *Respondents*

On Petitions for Writs of Certiorari to the United States Court of Appeals for the Fifth Circuit

REPLY BRIEF OF PETITIONER EL PASO NATURAL GAS COMPANY

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REPLY BRIEF OF PETITIONER EL PASO NATURAL GAS COMPANY

Petitioner El Paso Natural Gas Company files this Reply Brief to review the judgment and opinion of the United States Court of Appeals for the Fifth Circuit entered in this proceeding on December 13, 1976.

ARGUMENT

1. Local Property Law Rules Do Not Determine The Outcome Of This Case.

Reversioners[1] contend that the local property law rule forbidding a lessee from encumbering the reversionary estate effectively resolves this case. Notwithstanding the elaborate reiteration in which it is couched, their argument is essentially a simple one: under local law, Gulf Oil Corporation ("Gulf") could not deal in the reversioners' estate; and therefore, because the Natural Gas Act contains no express provision modifying this rule, Gulf could not dedicate reversioners' gas to the performance of its interstate sale.

The reversioners misstate the issue. This case does not involve a question of local property law as the reversioners contend. It involves the question of dedication of gas to interstate commerce under the Natural Gas Act. It is the Natural Gas Act, not local property law, that establishes the obligation to continue deliveries of natural gas in interstate commerce absent Section 7(b) abandonment authorization. *Atlantic Refining Co.* v. *Public Service Commission (CATCO),* 360 U.S. 378 (1959). In the companion cases, *Sunray Mid-Continent Oil Co.* v. *FPC,* 364 U.S. 137 (1960), and *Sun Oil Co.* v. *FPC,* 364 U.S. 170 (1960), this Court

[1] The Respondents in this case, Southland Royalty Company, *et al.*, Texaco Inc., Exxon Corporation and Mobil Oil Corporation are all mineral fee owners of the leases here in question and, for convenience, are referred to as "reversioners." References in this brief to "Southland" refer to the following mineral fee owners who collectively filed a brief in this proceeding: Southland Royalty Company, the trustees under the will of Warren Wright, the Penn interests, Exxon Corporation and Texaco Inc.

held that the obligation to deliver gas from dedicated reserves continues even after the underlying contract providing for the sale has expired. The principles expounded by this Court in these cases also apply to this case. Thus, the antecedent agreement between Gulf and its lessors to limit the term of Gulf's ability to dedicate gas to interstate commerce cannot override the obligation to continue interstate deliveries until such time as the Commission[2] grants abandonment authorization.

The reversioners attempt to distinguish *CATCO, Sunray* and *Sun Oil* on the grounds that the producers in those cases attempted to dedicate only their gas. They contend that the gas attributable to their reversionary interests is somehow different from Gulf's leasehold gas and that, under local property law, Gulf did not and could not dedicate the reversioners' gas to interstate commerce. In support, the reversioners analogize this case to one involving either a "split stream" in which some producers owning a share of production from a well dedicate their gas to interstate commerce while other owners do not, or to a vertical limitation in which a producer dedicates to interstate commerce only the gas produced down to a certain formation. The reversioners contend that Gulf's dedication of gas in this case was a limited dedication like the limited dedications in the split stream and vertical limitation cases, but limited in time rather than in space.

Despite the reversioners' contention, there is a critical difference between the time limitation on Gulf's

[2] "Commission" herein refers to the Federal Power Commission or its successor agency the Federal Energy Regulatory Commission, as appropriate.

leasehold interest and the physical division of deliveries in the split stream and vertical limitation cases. In the split stream and depth limitation cases, there are simultaneous flows of gas to two distinct markets, and the gas reserved from the sale in interstate commerce never actually flows in interstate commerce. More importantly, in those cases, there cannot be termination of the physical flow of gas in interstate commerce without Commission approval. In this case, however, Gulf requested and obtained from the Commission a certificate to sell all the gas from the underlying reserves without limitations and Gulf has sold gas to El Paso Natural Gas Company ("El Paso") from those reserves for 26 years. At the end of the lease term, if reversioners are correct, a stream of gas now flowing in interstate commerce will be physically diverted to another purchaser. Moreover, in the split stream and depth limitation cases, the interstate market could not become dependent on that part of the gas reserves intended for intrastate use because that gas is never physically sold in interstate commerce. In this case, the gas from the reserves underlying the leases has supplied El Paso's interstate customers since 1951. El Paso has built major interstate gas transmission facilities in partial reliance on these gas reserves (App. 403, 409) and El Paso's customers in turn justifiably have relied on these gas supplies.

Properly viewed, therefore, the question here is not the applicability of local law determining ownership interests, but, rather, whether a lease provision limiting the duration of the lessee's right to produce reserves may supplant the Commission's authority under Section 7(b) to determine whether the cessation of deliveries from the dedicated reserves is in the public interest. *CATCO, Sunray* and *Sun Oil* establish quite

clearly the principles that gas once dedicated remains dedicated absent Section 7(b) authorization and that Section 7(b) may not be overridden by private arrangements to limit the term of one's dedication. The private rights and obligations at stake here are no different from the rights and obligations in question in *Sunray*. Just as the parties to the leases in this case intended that Gulf's obligation to produce and sell the gas would terminate after the 50-year term expired, the parties in *Sunray* intended that all rights and obligations to sell the gas would terminate when the gas sales contract ended. This Court has nevertheless held that Section 7(b) must prevail over the expectations of the parties as expressed in their private agreements. The fact the transactions here involve leases rather than contracts is not dispositive of Commission jurisdiction. *See United Gas Improvement Co.* v. *Continental Oil Co. (Rayne Field)*, 381 U.S. 392, 400 (1965). The leases, like the contracts in *Sunray*, are simply private arrangements to limit the duration of the sale of gas. For the reasons expressed in *Sunray*, a time limitation on a sale, whether by contract or lease, must be subject to Section 7(b).

Neither may the reversioners contend that they never authorized Gulf to sell "their" gas. Under local law, Gulf was under an implied duty to develop the leases and to sell the gas that it discovered and produced, provided that it could obtain reasonable terms and conditions for its sale. *See Cole Petroleum Co.* v. *United States Gas & Oil Co.*, 121 Tex. 59, 41 S.W.2d 414 (Tex. 1931). At the time Gulf agreed to sell the gas to El Paso in interstate commerce, none of the reversioners disapproved of Gulf's sale, and indeed, no one has argued in this case that Gulf was derelict

in its duty to the reversioners by selling the gas during the term of the leases to El Paso.

It is sheer hyperbole for the reversioners to contend that the Commission's order in this case amounts to a "radical innovation." (Southland, at 18). The Commission's order has not disturbed the reversioners' property interest in the gas yet remaining in the ground. The Commission has merely recognized that gas from these reserves has long been flowing in interstate commerce, that it is thereby dedicated to interstate commerce,[5] and that the termination of this flow requires Commission authorization under Section 7(b) of the Natural Gas Act.

2. Decisions Under The Interstate Commerce Act Fully Support The Commission's Order In This Case.

The reversioners have argued that practical differences between the railroad and natural gas industries, as well as differences in the ways that leases are used in each, are evidence that the abandonment provisions in the two federal statutes governing these industries are not analogous. Second, they contend that the cases interpreting Section 1(18) of the Interstate Commerce Act, if relevant at all, support their position with respect to Section 7(b) of the Natural Gas Act. Specifically, they say that in light of *Meyers* v. *Famous Realty, Inc.*, 271 F.2d 811 (2d Cir. 1959), *cert. denied*, 362 U.S. 910 (1960), unless a lessor of property used by a certificated "carrier by railroad" is himself a certificated carrier, Section 1(18) does not require the lessor to obtain abandonment authorization when the lease expires. Thus, it is argued, the cases construing Section 1(18) suggest that the reversioners

[5] *See California* v. *Lo-Vaca Gathering Co.*, 379 U.S. 366 (1965).

here need not obtain abandonment authorization before they may sell their gas to purchasers of their own choosing.

This line of argument misconceives the thrust of the Interstate Commerce Act cases and their application to this case. The central question presented in those cases, as in this one, is whether the federal agency concerned possesses jurisdiction under the applicable statutes to protect the continuity of interstate service in the face of an expired or terminated lease. In *Smith* v. *Hoboken R.W. & S.C. Co.*[6] and *Thompson* v. *Texas Mexican R. Co.*,[7] this Court held quite clearly that it does. These two cases establish beyond any doubt that the obligation to maintain facilities in an interstate service, and thus to maintain the service itself, does not lapse with the expiration of a lease. No reason exists why operating differences between railroad and natural gas industries, and the way that leases are used within each, should affect the application of this principle. Rather, the principle applies to this case because the language and purpose of Section 7(b) of the Natural Gas Act are counterparts of the language and purpose of Section 1(18) of the Interstate Commerce Act. The provisions in both Acts, in accord with the long established law of public utility regulation,[8] are designed to protect the continuity of interstate commerce.

[6] 328 U.S. 123 (1946).

[7] 328 U.S. 134 (1946).

[8] "The obligations to continue service from whatever source they arise are binding, not only upon the original parties, but also upon all subsequent parties operating the utility." Hall, *Discontinuance of Service by Public Utilities*, 13 Minn. L. Rev. 181, 196 (1929).

Meyers does not contradict this principle and, indeed, is largely inapposite in the context of this case. *Meyers* concerns a subsidiary question under the Interstate Commerce Act; namely, whether a lessor who is not otherwise qualified or certificated to be a carrier by railroad may be required to become one merely by virtue of owning facilities or realty which are used in an interstate railroad service. This question presents what is essentially a practical problem: which of the parties to a lease may be obligated to continue an interstate railroad service when a lease expires; or, in the words of the court, whether Section 1(18) leads "to the absurd conclusion that one renting a patch of a cornfield to a railroad would come under an obligation to operate that railroad if it obtained permission to abandon the operation of its line." 271 F.2d at 815. As the court there held, Congress did not intend that a person completely unqualified financially and technically to become a carrier by railroad would acquire the status of carrier by railroad as a matter of law simply because he had leased property to a certificated carrier.[7] However, *Meyers* did not challenge the

[7] With respect to this question, under the Natural Gas Act one may become a natural gas company simply by filing with the Commission appropriate papers indicating that a succession-in-interest has occurred. *See Graridge Corp.*, 30 FPC 1156 (1963). In succession-in-interest cases, the Commission undertakes no new review to determine whether a sale by the successor satisfies the public convenience and necessity standard. *Id.* The reason quite clearly is that apart from the Commission's review of the price and related terms under which the sale is to be made, no special qualifications are needed to engage in interstate sales of gas. In many cases, in fact, the pipeline-purchaser performs all necessary construction and maintenance on the producing properties and the producer simply receives revenues. In this case, of course, there is no question that the reversioners are qualified to make sales of natural gas, since they have contracted to do so with an intrastate purchaser.

principle that the Interstate Commerce Commission has authority to protect the continuity of interstate service, inasmuch as the carrier in *Meyers* was required to, and did in fact, obtain abandonment authorization prior to the termination of the interstate service. 271 F.2d at 813. The principle embodied in the Interstate Commerce Commission cases, then, suggests quite clearly that the interstate service in gas from the reserves underlying Gulf's leases may not be terminated without Commission authorization.

3. The Commission's Jurisdiction Is Necessary In Order To Effectuate The Purposes Of The Natural Gas Act.

The Natural Gas Act does not deal expressly with the Commission's jurisdiction over gas which is the subject of an expired lease. Contrary to reversioners' contentions (Southland at 43; Crane County at 7; *see also* Louisiana at 12), this circumstance makes it entirely proper, when deciding the jurisdictional question presented here, to consider the purposes for which the Act was passed and the potential impact on the consuming public.

Petitioners have already described the impairment of the Commission's ability to assure a reliable supply of gas to the interstate market which would result from the lower court's decision. Contrary to reversioners' contentions (Southland at 38-41), this impairment has not been prevented by the excision on rehearing of the two sentences from the opinion of the court of appeals in *Pennzoil Producing Co.* v. *FPC*, 553 F.2d 485 (5th Cir. 1977). It results, in the first place, from the lower court's decision in this case. Further, the decision in *Pennzoil* illustrates the potential for disruption to interstate supplies which exists,

even though the court has deleted the two sentences that make these implications of the decision explicit. Indeed, the states of Texas, Louisiana and New Mexico have clearly recognized that the lower court decision may have application to a number of situations now present before the Commission or the courts. (Texas at 9-16; Louisiana at 3-5; New Mexico joins in support of Texas brief).

Texas is mistaken, however, in forecasting that substantial disruptions in mineral titles will result from the Commission's order in this case. Under the factual circumstance presented here, the presence of an existing well connection with an interstate pipeline and the need to terminate deliveries in order to divert the flow to a new purchaser provide abundant notice to any new lessee that an interstate dedication may have been made. Moreover, it is important to note that title to the gas will not be affected by the earlier dedication. Rather, the principal impact upon the new lessee is that he may not be able to obtain the higher intrastate rate.

Further, not all of the situations hypothesized by Texas are governed by this case. Texas cites, in particular, the case of *Wessely Energy Corporation* v. *Arkansas-Louisiana Gas Company and the FPC,* No. CIV-77-0159-B (W.D. Okla., issued July 29, 1977, appeal pending). (Texas at 12). There, an interstate purchaser claimed that gas reserves discovered by a new lessee were dedicated to it by virtue of a contract with a previous lessee whose lease had terminated. The previous lessee in *Wessely,* however, had never discovered or produced gas from its leasehold interest and, therefore, there had never been a flow of gas into interstate

commerce from the producing properties covered by the lease. El Paso has never contended that the situation presented in *Wessely* will be controlled by the outcome here. El Paso has argued only that the physical flow of gas in interstate commerce and the resulting reliance of the interstate market on such gas supplies necessarily entail the burden to continue deliveries until the Commission authorizes an abandonment.[3] We submit that there is no reason why this Court should base its decision here on a consideration of that unrelated case.

Finally, the risks to which Texas points are largely present whenever producing properties are transferred. In all succession-in-interest cases, a prior unrecorded dedication to interstate commerce may exist to encumber the transferred estate. Although in such cases assignees generally protect against such a risk by means of covenants or warranties, the possibility of prior encumbrances in succession-in-interest cases apparently has not unsettled the state of title prior to this time nor discouraged drilling.

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[3] Texas also cites the case of *Northern Natural Gas Co.* v. *John L. Crawford,* —— F.P.C. ——, Docket No. CS71-6 (issued September 29, 1976), *appeal docketed sub nom. Harrison* v. *FPC,* No. 76-4318, 5th Cir., December 9, 1976. In that case, a lessee made certificated deliveries of gas from its leasehold but later released his interest in certain parcels of land covered by the lease from which no deliveries had been made. *Crawford* presents a more difficult situation than *Wessely.* El Paso believes that *Crawford* and similar cases cannot be decided on the basis of the record presented here. Rather, the Commission should be left free to determine its jurisdiction in such cases on the basis of the facts as they there appear. However, if the Court affirms the lower court's decision in this case, the result may well be to foreclose the exercise of Commission jurisdiction over gas covered by terminated leases even in those cases where it would clearly be warranted.

The reversioners have suggested that if the Commission is presented with leases which permit the parties to withdraw gas from interstate markets, the Commission has adequate authority to deal with such situations. The solutions which the reversions have offered, however, are not workable, nor do they provide sufficient protection for interstate gas consumers. They have suggested that the Commission may correct any abuses it perceives in leasing practices either through a denial of a certificate or by means of its authority to attach certificate conditions pursuant to Section 7(e) of the Act. (Southland at 44-45; *see also* Texas at 19-20). As this case illustrates, mineral leases are not filed with the Commission in the usual case, so that the Commission normally has no occasion to review them until they are subsequently altered or terminated.

In actuality, the Commission's conditioning powers, if applicable at all, provide no greater authority than its ability to deny a certificate. To condition a certificate upon the submission of an amended lease is simply to deny the certificate. Thus, at bottom, all that the reversioners have suggested is that the Commission may accept new gas dedications on the terms offered by parties to a lease or forego that opportunity of securing the gas for the interstate market. The choice implicit in this solution was not the sort contemplated by the drafters of Section 7(b). The intention so clearly stated there is that a certificated service in natural gas, once begun, be continued until the Commission approves its termination. The Commission's order in this case is consistent with that purpose and should be affirmed.

CONCLUSION

Accordingly, the judgment of the United States Court of Appeals for the Fifth Circuit entered in this case should be reversed.

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